
AN ALTERNATIVE URBAN DEVELOPMENT STRATEGY TO ADDRESS THE PORTLAND METROPOLITAN AREA'S HOUSING AFFORDABILITY CHALLENGE

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From 2000 to 2014 the number of individuals in the Portland metropolitan area grew by 400,297. During this same time only 155,704 units of housing were constructed. With the changing household demand driven largely by creative class workers and millennials, the majority of which prefer single occupant housing, we estimate this housing shortfall exceeds 40,000 units, or 4,000 units annually over the next decade. The overwhelming housing preference for many individuals including creative class professionals is to be urban and walkable. This accounts for

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the higher rent growth in the urban core. Addressing this urban housing shortfall is also supportive of attracting high wage jobs which will benefit the entire region.

To address the shortfall we recommend removing barriers in support of 25,000 units of new high-rise housing in Portland's walkable urban core, 15,000 units of mid-rise housing at transit locations and 9 million square feet of urban office space to attract new economy jobs. The ratio is 2,500 units annually in the urban core (60 percent of demand) and at 1,500 units annually at transit locations (40 percent of demand). Both locations can produce the required housing with minimal impact on public infrastructure and transportation.

Developing effective solutions to address the Oregon's housing affordability challenge is an important policy imperative. However, to achieve a sustainable balanced market this challenge must be addressed in conjunction with policy that supports an adequate supply of housing, higher workforce wages, increased resources for education, police, fire, parks, and transportation. Only when each of these are effectively addressed will employers and citizens develop the confidence to invest in a sustainable way towards a successful future.

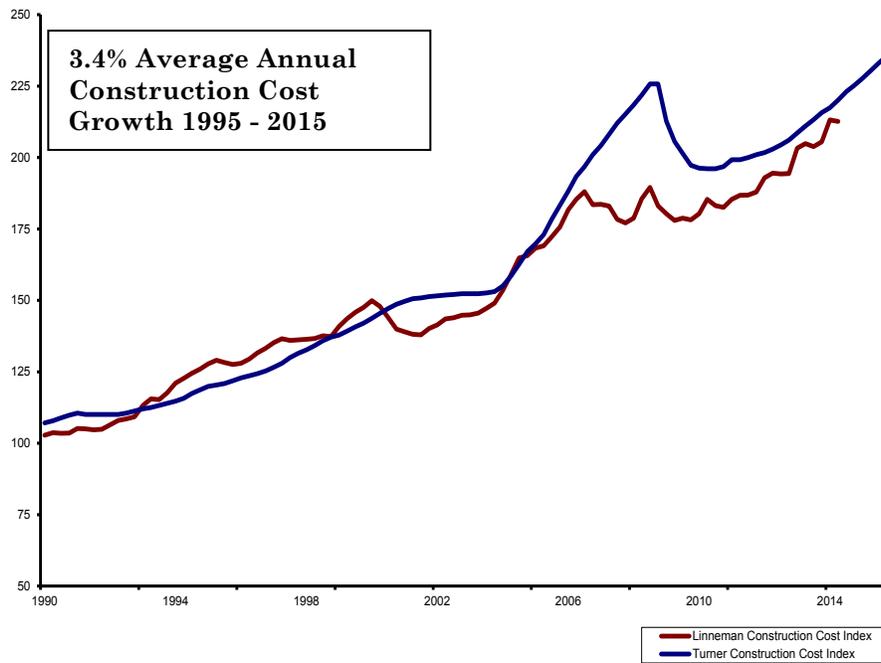
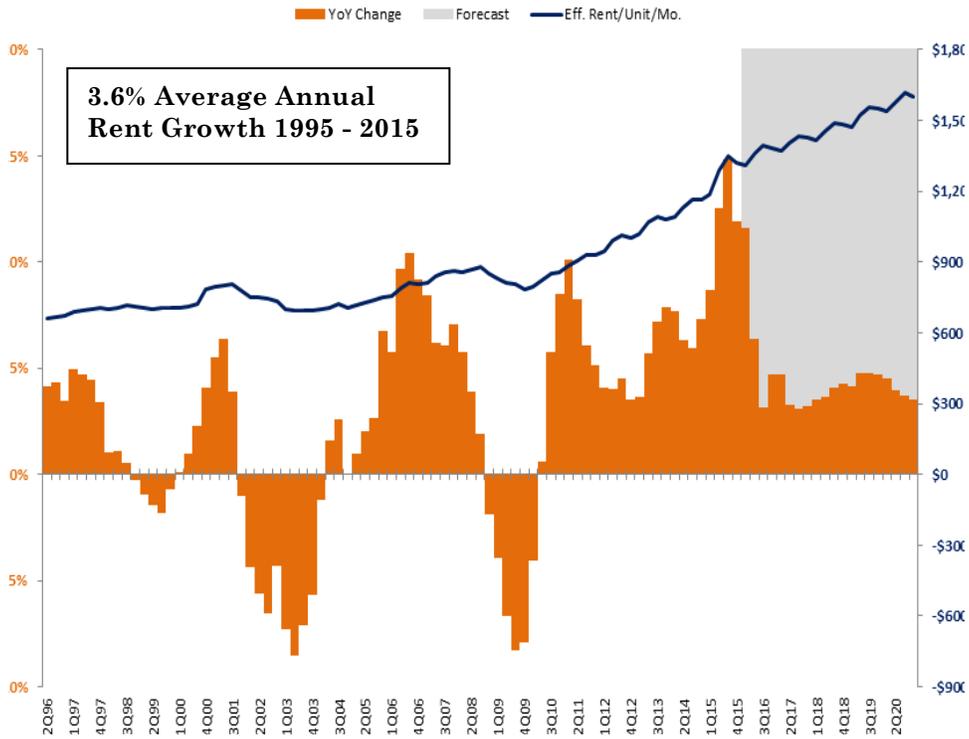
BACKGROUND

Oregon state government, Portland city government, and Metro regional government have long been celebrated for their vision and land use policies. The region's urban growth boundary and investments in public transportation have been widely recognized as visionary. The goal for our Alternative Urban Housing Strategy is to develop and implement an effective affordable housing policy mandate that will be recognized as equally successful as the region's land use policies.

Empirical research included in Exhibit 2 shows that not only have rent control and inclusionary zoning policies implemented throughout the United States failed at their stated goals of producing adequate affordable housing, but have actually had the opposite effect of dampening housing production and increasing the housing cost burden.

The State of Oregon has considered lifting the current prohibition on inclusionary zoning, opening up the possibility that these policies will be implemented in Portland and other Oregon cities. This industry analysis establishes an alternative approach to addressing the Portland metropolitan area's housing affordability challenge through development driven solutions, and by providing additional benefits to the community such as increased funding for critical services including education, transportation, utilities, police, fire and parks.

Over the past 15 years, the cost of rental housing in the Portland Metropolitan Area has increased 3.6 percent annually. The recent rates of increase have lifted the actual decreases in rent levels in the late 1990's due to overbuilding, the tech bust from 2000–2005, and the 2008–2011 financial crisis. During the same period construction costs increased approximately 3.4 percent according to the Turner and Linneman Construction Cost Reports.



ALTERNATIVE POLICY OPPORTUNITY

We have prepared the following alternative to the current discussion on inclusionary zoning in support of housing that is affordable to Oregon's workforce, living wage jobs, adequate funding for police, fire, parks and transportation, along with increased resources for Oregon's schools.

Adequate Supply

The only way to have housing that is affordable to all income levels is to have an adequate overall supply of housing. To achieve this, you have to measure demand and deliver a supply at or above demand. Only by removing barriers to housing construction will it be possible to increase production and hold rising costs in check over the long term. One possible cost effective solution to providing affordable housing is to subsidize eligible households accessing the private market.

Inclusionary zoning will not result in increased housing production. Powell & Stringham (2004) show that this policy has a chilling effect on the amount of housing produced. In Los Angeles, for instance, the thirteen LA metro municipalities that adopted inclusionary zoning policies produced 17,296 less homes in the seven years following the enactment of the policy than in the seven years prior.¹

Measuring the Cost Necessary to Add the Next Unit of Housing

When you make the next available unit of housing more expensive you make the entire market more expensive. Before lenders and investors can approve a new project, an appraisal is required to confirm if the market rents support the development costs. When an appraiser is hired to opine on rents for a possible new development he completes a market survey to determine if the market will support the rents necessary to make the development feasible.

If market comparables indicate that expected new development rents are above market, the development will be delayed until rents increase sufficiently to justify the costs. So if you raise the level of costs necessary to develop a new unit, you will have to wait until the market moves its rent base up to support that new required rent level. Higher costs will result in fewer projects being economically feasible. In other words, if the goal is to produce more affordable units, it is misguided policy to adopt a program that inherently imposes higher costs on housing production in order to encourage additional supply. A current underwriting model analyzing the full costs of inclusionary zoning is attached as Exhibit 1.

Realization on Infrastructure Investments

Cities have made enormous investments in roads, public transportation, utilities, schools and parks. What is missing in housing policy is an effective conversation about how to **maximize the return on these investments** and to **minimize the**

¹ Powell, B., & Stringham, E. (2004). Do Affordable Housing Mandates Work? Evidence from Los Angeles County and Orange County. *Reason Foundation*.

future costs in each area along with the ongoing maintenance costs of those services.

For example, in the urban core you can build a mid-rise structure of seven stories (five stories of wood construction over two levels of concrete). Or on that same block you could build a high rise development. In the high-rise you will have approximately three times the number of units and rentable area than the mid-rise building, three times the impact fees, and three times the property tax. So if a high-rise with greater density is built instead of a mid-rise, government will have three times the return on investment in its existing infrastructure with little or no incremental cost to the public. We believe that this is a critical component of the housing equation, since the costs to the city are nearly the same for each development, when you factor in the costs of the lost housing opportunities and transporting the individuals who would have been able to walk to work, shopping, and entertainment in the urban environment at no additional strain to existing infrastructure, the benefits of building in the urban core are even more compelling.

Costs of Transportation

Prior to World War II cities were walkable and public transportation connected cities and suburbs providing easy and affordable transportation to many citizens. Today the actual incremental cost of providing services (roads, water, sewer, schools) to different forms of new housing is rarely calculated. In the urban core, individuals walk on existing sidewalks, hitch rides on existing mass transit, and drive on existing streets. That is all at a zero or very low incremental cost to the public. The second lowest cost product is housing that is walkable to transportation hubs. The most expensive costs to cities and taxpayers is housing that requires extending and maintaining roads and other services, particularly in areas not served by public transportation.

Costs of Education

The historical ratio of children in new construction single family housing is 0.64:1. So when 100 new single-family homes are built, the local schools have to anticipate that over time they will be educating 64 new students. For apartments the ratio is 0.31:1, or approximately half of the new construction single family residential. However for new construction urban high-rise housing the ratio is 0.12:1, or less than one-fifth the ratio of new construction single family.² But when impact assessments are made, the urban units are assessed at the same rate as farther out housing with greater student demand. This is another cost layered on to downtown development, with benefits flowing away from the center of development.

² All figures are NMHC tabulations of data from the America Housing Survey. See Research Notes, "Apartments and Schools," NMHC, August 24, 2001, available at: www.nmhc.org/Content/ServeContent.cfm?ContentItemID=2620&IssueID=80. A recent study using data from the 2001 Residential Finance Survey suggests a smaller differential, though one that has grown over time. See Jack Goodman, "Houses, Apartments, and the Incidence of Property Taxes," Housing Policy Debate, Vol. 17, Issue 1, 2006.

Transportation, Utilities, Police, Fire and Parks

In the urban environment all of these services are fully provided. In outlying areas each of these services needs to be extended to serve the new development at a significant costs to the city, county and state. The Brookings Institute and Smart Growth America have studied the issue and came to the conclusion that property taxes associated with suburban developments in fact always lose money for the municipality based on the incremental costs of new roads, sewers, police, schools, etc.

Living Wage Jobs

We have conducted research into long term wage growth in cities that are attracting new economy and technology related jobs. What we have found is that the positive income effect of increasing the tech job base raises the income levels of all other job classes in the city providing an overall economic lift. The question you have to answer if you are seeking to attract new tech jobs is: are you providing the housing that they desire, which is walkable, urban infill close to jobs, shopping, entertainment and key services. If yes, then adding these jobs will not increase your market cost of housing. If no, then the individuals in these tech jobs will outbid those in the locations they seek and you will raise the cost of housing for the entire market. This displacement then ripples through the entire housing stock.

Jobs Center

Technology employers are in intense competition for top talent. That top talent wants to live in an urban location with a walkable lifestyle. The result is that tech companies have moved into cities like Portland, Seattle and Denver to recruit the employees who are attracted to the lifestyles offered by those cities. At a macro level, Portland must develop more urban and transit-oriented housing or risk becoming non-competitive compared to cities such as Seattle and Denver.

With these principles in mind, we suggest an alternative to mandatory inclusionary zoning that will attract investors and developers to produce the types of housing sought after by the market and at price points that residents can afford.

RECOMMENDED HOUSING POLICY CONSIDERATION

We recommend removing the barriers to production of 25,000 units (2,500 annually) of new high-rise development within the existing urban fabric and 15,000 units (1,500 annually) in midrise projects that are within a half mile of transit stop locations. These locales will leverage the public services already in place and enable residents direct access to walkable employment and public transportation.

Barriers to such development include zoning restrictions, floor-to-area ratio (FAR) restrictions, permit timing, code alternatives, financing and amortization of the assessed impact fees from the new property taxes generated and offsets to structured parking which enable full density solutions.

Assuming an average 300-unit development scale (similar to a project like Ladd Tower located in downtown Portland, adjacent to the South Park Blocks), production of 25,000 new units can be accomplished by constructing 80 new urban communities. Our estimate is that 8-12 communities can be developed annually so we can feasibly produce the contemplated housing over a ten-year implementation timeframe if barriers are eliminated to enable this new development to occur. For mid-rise units around transit stops communities would average 250 units. To accomplish this goal 60 new communities would be constructed, which we estimate could be built at a pace averaging eight communities per year over an eight-to-ten-year timeframe. Using the Orenco Station solution three times the expected density was achieved when the development barriers were removed. See development overview attached as Exhibit #3.

RESULTS OF POSSIBLE ALTERNATIVE HOUSING POLICY

Incremental Impact Fees. Current Portland System Development Charges for Schools, Transportation, Parks and Water System are approximately \$9,305 per unit.

Analysis of Incremental SDC and Tax Revenue Potential (Achieved Over a 10-Year Implementation Period)			
	Base Case³	Densification Scenario⁴	Incremental Impact Fees/Taxes
Multi-Family Housing Production	19,512	59,512	40,000
Average Real Market Value per Unit	\$275,000	\$327,510	\$353,125
Average Assessed Value per Unit ⁵	\$135,190	\$161,004	\$173,596
System Development Charge (SDC) Revenue			
Schools	\$ 27,073,430	\$ 82,575,035	\$ 55,501,604
Transportation	\$ 40,523,020	\$ 123,596,817	\$ 83,073,797
Parks	\$ 107,861,331	\$ 328,981,331	\$ 221,120,000
Water	\$ 6,095,617	\$ 18,591,874	\$ 12,496,257
Total SDC Revenue	\$ 181,553,399	\$ 553,745,057	\$ 372,191,658
Annual Property Tax Revenue			
Education Tax Revenue	\$ 19,464,346	\$ 70,703,015	\$ 51,238,669
General Governmental Tax Revenue	\$ 38,141,046	\$ 138,544,954	\$ 100,403,909
Bonds and Misc. Tax Revenue	\$ 4,705,313	\$ 17,091,754	\$ 12,386,441
Total Annual Property Tax Revenue	\$ 62,310,705	\$ 226,339,723	\$ 164,029,018

³ Assumes multi-family housing production consistent with average annual multi-family production experienced in City of Portland from 2004 – 2014. *U.S. Census Bureau Annual New Privately-Owned Residential Building Permits (Portland, Oregon (Multnomah County – 051))*

⁴ Assumes production of 4,000 additional multi-family units per year at densities which are three times the historical average.

⁵ Assessed Value adjusted for 49.16% Multnomah County Change Property Ratio

While there are incremental costs to serve additional urban units these costs pale in comparison to the costs of extending new services to outlying areas.

Increased Property Taxes. 25,000 units of high rise housing will increase the tax base by approximately \$400,000 per unit. 15,000 units of mid-rise housing will increase the tax base by \$275,000 per unit. That translates into \$6.9 billion in new tax base or annual new tax revenue of approximately \$164 million at a 23.6222 millage rate for properties located in Portland's urban core and transit oriented locations. Using a debt rate of 3.0 percent and a 1.5 coverage factor these new taxes will support approximately \$3.6 billion of new bonding capacity.

Increased Living Wage Jobs

Of the \$14.1 billion in investment in new housing approximately 60 percent or \$8.5 billion will be for construction activities. Based on our history, the level of profit in the contract base is approximately 15 percent or net taxable income of \$1.3 billion netting the state approximately \$127 million of incremental income taxes at 10 percent. Payroll runs about 50 percent of the construction activities so using an estimated payroll tax of 1.71 percent this will increase income from payroll deduction of \$72.5 million. Additional taxes will total \$339 million, at an 8 percent average on construction wages.

Support of New Economy Jobs

The 40,000 units of housing will provide housing for approximately 60,000 new residents. This will support approximately 15,000 baby boomers (25 percent) seeking to downsize and move into the urban environment and 45,000 new individuals coming to Portland. Technology employers are using office space at 5 individuals per 1,000 square feet so this level of housing will support 9 million square feet of new office development in the urban core or 20 new office developments of scale. The cost of new office development is approximately \$400 per square foot so this new office development will result in another \$1.8 billion of new property tax base. This will also result in another \$42 million annually of new property taxes with other positive contributions to impact fees and living wage jobs.

The National Association of Home Builders prepared a study analyzing the impact of building 100 multifamily units in a typical metro area. (National Association of Home Builders, Housing Policy Department, 2009) In the study, NAHB concluded that for every 100 units developed 122 local jobs are supported.⁶ In the case of high-rise development, these impacts are roughly doubled. Over the contemplated ten-year implementation program of developing 40,000 units (4,000 annually) across 80 high-rise and 60 mid-rise developments, there will be approximately 5,000 local jobs supported.

⁶ National Association of Home Builders, Housing Policy Department. (2009). *The Local Impact of Home Building in a Typical Metro Area*. Washington, DC: National Association of Home Builders.

We have only calculated the direct effect of this new investment into housing and office. The multiplier effect of these investments are approximately 2.5 so the full value of these positive impacts will be substantially in excess of what is outlined above.

Support for Affordable Housing

If only 25 percent of the incremental property taxes are allocated to supporting housing that is affordable at income levels determined by the city and state then a fund of approximately \$51 million per year will be available. Current average rents in Portland are \$1,325. A subsidy of \$206 monthly will enable over 21,000 households to achieve housing costs at the 80 percent AMI level or \$1,119. The recommendation we have is to provide individuals such as teachers, firemen, police, and others working in the urban core the opportunity to “buy down” the cost of housing from the Portland average of \$1,325 per month to an 80 percent AMI level of \$1,119 per month. Please consider that this housing is being added into areas where the costs to serve the units is a small fraction of the revenue gained.

SUMMARY AND CONCLUSION

If we focus on reducing barriers to providing the housing necessary to attract the jobs that will raise the standards of living for all Oregonians, everyone wins. In addition there is direct support for over 21,000 units being reduced from the current average rental cost to affordable at an 80 percent AMI level. This can be accomplished at the lowest possible cost to citizens and which will provide increased funding for transportation, education, police, fire, parking, transportation and other services are at the highest level over costs for any housing product in the region.

We recommend that the State Legislature focus on policies designed to encourage housing construction when designing solutions intended to increase the affordability of housing before putting inclusionary housing policies in place. By effectively reducing supply, affordable housing policies that impose additional burdens on the production of housing will have the opposite effect to the stated goals. ■

EXHIBIT 1. THE COST OF THE NEXT AVAILABLE UNIT**Case Study: 14th & NW Glisan, Portland, Oregon**

If the Proposed Inclusionary Zoning Bill becomes law, 14th & NW Glisan may be subject to an up to 30 percent affordable housing requirement. In order to maintain a return that enables development by the private sector, the remaining market rents units must increase by 21 percent to cover the reduced revenue from the affordable units.

Case Study: 14th & NW Glisan, Portland, OR		
Inclusionary Requirement	30.0%	@ 80% of Median Income
Average Unit Size	622	Square Feet
Unit Mix		
No. of Affordable Units (30% Required)	73	Units @ 80% of AMI
No. of Market Rate Units	171	Units @ Market
Total Units	244	Units
Rents		
Market Rent	\$ 2,191	per Month
Affordable Rent @ 80% of AMI	1,119	per Month
Subsidy	\$ 1,071	per Month
Projected Revenue		
Revenue on 244 Market Rate Units	6,415,248	\$ Annually
Less: Subsidy (73 units * \$1,071, annualized)	(938,481)	Annually
Revenue with Inclusionary Requirement	\$ 5,476,767	
Annual Inclusionary Tax on Each New Market Rate Unit	5,488	\$ Annually
Monthly	\$ 457	= 20.9% Increase

Effect on Affordability in Downtown Portland	
Units Necessary to Meet Market Demand	40,000
Who Suffers?	
70% Market Rate (70% of 40,000)	28,000
Current Rental Stock	125,019
Total Rental Stock	153,019
Additional Annual Rent	
New Units at 28,000 × \$457 × 12	\$ 153,860,784
Existing Units × (20.9% × \$1,324 × 12)	\$ 415,137,091
Total Additional Annual Rent	\$ 568,689,091
Capitalized at 5% Rate of Return	\$ 11,373,781,825
Economic Burden per Unit for 12,000 Affordable Units @ 80% of AMI	\$ 947,815 Per Unit

- We expect that the housing stock in Portland needs to increase by an incremental 40,000 units (4,000 units annually) to meet market demand.
- In order for the private sector to finance this growth, the existing rental stock of 153,019 units will experience an additional 21 percent monthly burden.
- An inclusionary housing requirement is not a solution for affordability.
- The solution to facilitate housing construction is decreasing the cost to deliver each unit, therefore increasing access to supply and affordability.

Using this project as an example, we have analyzed the impacts on development cost structure and resulting feasibility of the development assuming varying affordable set-aside requirements and affordability requirements.

Given current institutional equity yield requirements of approximately 5.50 percent for residential investment in the Portland market, below is the discount to land value developers will face given varying set-aside requirements and mandated affordability level requirements.

**Land Purchase Price Reduction for Multi-Family
Residential Development As a Result of Inclusionary Zoning (\$ in Millions)**

	Affordable Set-Aside Land Price Reduction						
	0%	5%	10%	15%	20%	25%	30%
60% of AMI	\$ 0.0	\$ (3.3)	\$ (6.7)	\$ (10.3)	\$ (13.6)	\$ (17.0)	\$ (20.3)
80% of AMI	\$ 0.0	\$ (2.6)	\$ (5.3)	\$ (8.2)	\$ (10.8)	\$ (13.5)	\$ (16.1)
100% of AMI	\$ 0.0	\$ (1.9)	\$ (3.9)	\$ (6.0)	\$ (7.9)	\$ (9.9)	\$ (11.8)

**Land Price Discounts for Multi-Family
Residential Development As a Result of Inclusionary Zoning**

	Affordable Set-Aside Percentage Land Price Reduction						
	0%	5%	10%	15%	20%	25%	30%
60% of AMI	0%	39%	79%	121%	161%	200%	239%
80% of AMI	0%	31%	62%	96%	127%	159%	190%
100% of AMI	0%	23%	46%	70%	93%	116%	139%

As the tables above illustrates, in today's rising construction cost environment mandating affordability set-asides results in impacting deal economics to the point of project infeasibility.

Land Use Alternatives

In the open market land owners have multiple options for realizing their land's full market value. They can hold and capture the existing use, develop for hotel, develop for office, develop for retail or a governmental use. If the Inclusionary Zoning requirements are instituted it will result in residential developers being unable to compete with land values supported by other uses. In other words, the highest and best use of land otherwise suited for residential development will be forced to another use due to the onerous economics. As a result, Inclusionary Zoning will result in the counterproductive outcome of significantly diminishing the number of sites available for housing production and further constricting supply.

EXHIBIT 2. RESEARCH SUMMARY

Below are key findings from several experts engaged in the discussion related to Inclusionary Zoning.

Do Affordable Housing Mandates Work? Evidence from Los Angeles County and Orange County. (Powell & Stringham, 2004)

Inclusionary zoning produces few units, has high costs, makes market-priced homes more expensive, restricts the supply of new homes, and reduces government revenue. Price controls do not address the cause of the affordability problem. The real problem is government restrictions limit supply and increase costs.

Inclusionary zoning has failed to produce a significant number of affordable homes due to the incentives created by the price controls. Even the few inclusionary zoning units produced have cost builders, homeowners, and governments greatly. By restricting the supply of new homes and driving up the price of both newly constructed market-rate homes and the existing stock of homes, inclusionary zoning makes housing less affordable.

California Assembly Bill 1229 Veto Letter. (Brown, 2013)

“As Mayor of Oakland, I saw how difficult it can be to attract development to low and middle income communities. Requiring developers to include below-market units in their projects can exacerbate these challenges, even while not meaningfully increasing the amount of affordable housing in a given community.”

The Irony of Inclusionary Zoning (Ellickson, 1981)

Most “inclusionary” programs are ironically titled. These programs are essentially taxes on the production of new housing. The programs will usually increase general housing prices, a result which further limits the housing opportunities of moderate-income families. In short, despite the assertions of inclusionary zoning proponents, most inclusionary ordinances are just another form of exclusionary practice.

The High Costs of Low-Income Housing. (Rosenthal, 2011)

Howard Husock, of Harvard's Joint Center for Housing Studies, believes that the government should allow builders to simply build housing the market wants and can afford, and that the government should stay out of the way.

The High Cost of Rent Control. (National Multifamily Housing Council, 2016)

Rent control has the perverse consequence of reducing, rather than expanding, the supply of housing in time of shortage. Harm caused by rent control includes inhibition of new construction, deterioration of existing housing, reduced property tax revenues, substantial administrative costs, reduced consumer mobility, and increasing consumer entry costs. From a social perspective, the substantial costs of

rent control fall most heavily on the poor, higher income households benefit most from rent control, promotion of housing discrimination, and unfairly tax rental housing providers.

Economists have long considered rent control a failed housing policy. Dr. Anthony Downs, a leading economist and nationally-recognized expert on housing policy, concluded in a recent report on rent controls, other than during wartime, the economic and social costs of rent control “almost always outweigh any perceived short-term benefits they provide.”

The Builder's Perspective on Inclusionary Zoning. (Tombari, 2005)

San Francisco Area: In 30 years, the 27 participating municipalities in the Bay Area managed to create 6,840 affordable units through inclusionary zoning requirements, or roughly 28 percent of the *annual* affordable housing need. When divided amongst the 6,840 units of housing produced, the “tax” on the area economy to create each affordable unit was \$321,637.42.

Los Angeles Area: The sum total of “affordable” housing units created in 27 years is 6,379, or roughly 51 percent of the *annual* affordable housing need. When divided amount the 6,379 units of housing produced, the “tax” on the area economy to create each affordable unit was \$596,546.

How Rent Control Drives Out Affordable Housing. (Tucker, 1997)

A look at the classified ads in rent-controlled cities reveals that very few moderately priced rental units are actually available. Most advertised units are priced well above the actual median rent. Yet in cities without controls, moderately priced units are universally available.

The lesson for the rest of the country is that rent control is policy that never was justified and certainly should be scrapped.

The Local Impact of Home Building in a Typical Metro Area. (National Association of Home Builders, Housing Policy Department, 2009)